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SUBJECT: South Africa: Minerals and Energy Newsletter "THE ASSAY" - Issue 6, June, 2009

This cable is not for Internet distribution.

¶1. (SBU) Introduction: The purpose of this newsletter, initiated in January 2004, is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

¶2. (SBU) CONTENTS:

HOT NEWS

Mining Production Down in May

¶3. (SBU) South African mining output fell by 14.5% in May year-on-year as major companies, including Anglo Platinum and Xstrata, cut production after slowing global economic growth reduced the demand for commodities. Mineral output other than gold fell by 15.1%, while gold production declined by 10.5% and local diamond production by 62.4%, according to Statistics South Africa. Anglo Platinum and Lonmin, the world's first and third biggest platinum producers, shut mines in South Africa on slumping demand for the metal, which is used mainly in jewelry and anti-pollution devices for cars. Xstrata and Samancor, the world's biggest ferrochrome producers, also closed furnaces. April's mineral sales dropped by 19.4%, to about $2.5 billion, and non-gold minerals dropped by 23.8%. Diamond production in May fell 1% compared to April and rose by 1.9% for the three months ending 31 May, compared to the previous quarter.

ENERGY

Sasol-Uzbekistan Gas-to-Liquids Venture

¶4. (SBU) Sasol, South Africa's coal-to-liquid fuels and petrochemical producer, announced on July 15 that it has signed a Joint Venture Agreement with Uzbekneftegaz (the National Oil and Gas Company of Uzbekistan) and Petronas of Malaysia for the development and implementation of a gas-to-liquids (GTL) project in Uzbekistan.

Sasol's Group General Manager, Petronas' Vice President, and Uzbekneftegaz's Chairman of the Board of Governors met with the Deputy Prime-Minister of the Republic of Uzbekistan for the signing ceremony in the country's capital of Tashkent. The GTL facility will employ Sasol's proprietary Slurry Phase Distillate (SPD) process to annually produce some 1.3 million tons of superior quality products such as diesel, kerosene, naphtha and liquefied petroleum gas (LPG). According to Sasol, its SPD is sought after worldwide as the process produces a clean-burning, high-performance fuel for diesel engines. The project now moves into the feasibility phase, which will be overseen by a joint venture company to be formed between the three partners.

GTL Plant Looking for Gas

¶5. (SBU) State-owned oil company PetroSA's Mossel Bay gas-to-liquid (GTL) plant is expected to run out of natural gas supply by 2011. The company is currently in talks to import 500,000-700,000 tons of liquefied natural gas (LNG) a year to help extend the life of its refinery to beyond 2015, according to PetroSA's vice president for new upstream ventures, Everton September. The process converts natural gas into high quality, zero sulfur, diesel, petrol and kerosene and the products are sold into local markets through major company retail outlets. PetroSA is currently looking for close-to-shore sites for an LNG offloading facility to minimize costs and transmission risks, but is meeting with resistance from wealthy home-owners who want the facility further away. The estimated cost of the offloading facility is $250 million and the company is also planning to spend $650 million to explore for new gas reserves. September said PetroSA was also in discussions with U.S. company Forest Oil regarding the development and supply of gas from their off-shore Ibhubesi gasfield.

¶6. (SBU) Limited gas resources off the west and south coasts of South Africa and Namibia have been known for decades. The south coast reserves have been exploited since 1992 to supply the world's biggest commercially operating gas-to-liquids (GTL) plant at Mossel Bay. The Ibhubesi gasfield off South Africa's west coast is 70%-owned by U.S. company Forest Oil. Ibhubesi's resource has not been fully defined, but is large enough to move ahead, according to Forest Exploration International commercial director John Langhus.

The company is awaiting production rights from the Department of Minerals, and if granted, could start production in 2012. The gas is likely to be used for electricity generation, with an initial production of 100 million cubic feet per day, rising to about 225 million cubic feet per day in the future. Langhus said the initial supply would be sufficient to power a base-load 700 megawatt combined-cycle gas turbine (CCGT) or a 400 megawatt peaking power open-cycle gas turbine (OCGT). The Kudu gasfield off the Namibian Qopen-cycle gas turbine (OCGT). The Kudu gasfield off the Namibian west coast, when operational, is expected to provide the bulk of its gas to the Cape. The South African company Gigajoule has announced a $300 million investment in infrastructure to transport the gas to industries in the Western Cape. It has applied to the National Energy Regulator (Nersa) for a license for this purpose and has signed a MOU with Tullow Oil, 70% owner of Kudu, for the supply of gas.

Anglo Platinum Fuel Cell Power

¶7. (SBU) Anglo Platinum (Angloplats) has unveiled a fuel cell power plant at sister company Anglo Coal's coalbed methane exploration site in the Waterberg coal field in Limpopo Province. The plant has begun converting methane gas to electricity. The demonstration unit was purchased from the U.S. company United Technologies UTC Power and can produce up to 200 kilowatts of electricity, sufficient to power the operations at Lephalale. An arrangement with Eskom will feed excess power back into the grid. The fuel cell also has the capacity to stand alone in the event of grid failure. It is said to

use about a third of the methane gas that Anglo Coal is producing at the site; the rest is being flared because carbon dioxide is a less harmful greenhouse gas than methane. While fuel cells are generally considered a clean energy technology, they have a small carbon dioxide footprint. Angloplats says it is considering applying for carbon credits for the project as the carbon dioxide produced by the fuel cell is about half that of a thermal power plant. About 270 of UTC's fuel cells have been installed around the world, but this will a first for Africa.

¶8. (SBU) Angloplats' interest in fuel cells lies in its use of platinum as a catalyst to generate the hydrogen that powers the cells. Angloplats has a 17.5% stake in Johnson Matthey Fuel Cells in the belief that fuel cells will drive long-term demand for platinum. Angloplats' head of market development and research, Anthea Bath, sees the Lephalale fuel cell as an important demonstration project that offers South Africa a "unique solution" for clean energy. Angloplats is partnering with the Department of Science and Technology to examine the application of fuel cells in Africa. Bath said the total installed cost of the Lephalale fuel cell was about $1.25 million, but she expected costs would eventually come down. The UTC fuel cell also produces heat that could be used in commercial building applications, such as space and water heating.

Eskom Gets 31.3% Tariff Increase

¶9. (SBU) The National Energy Regulator of South Africa (Nersa) has granted state-owned electricity utility Eskom a 31.3% power tariff increase, which includes an environmental levy. Eskom had asked for a 34% hike. The increase granted will run from July 1, 2009 to March 31, 2010, and will raise the average standard electricity tariff from the current SA 25.24 cents to SA 33.14 cents per kilowatt hour (about US 3.1 and US 4.1 cents per kilowatt hour, respectively). The increase will result in tariff revenues of between R62 billion and R64.7 billion ($7.75 billion and $8.09 billion, respectively). Nersa Chairperson Collin Matjila said the sustainability of Eskom, the security of electricity supply, and the affordability of electricity were the key considerations in Nersa's decision. He said low-income customers would receive an interim price hike of 15% until the implementation of special tariffs for the protection of the poor. Nersa said there would be further

above-inflation tariff increases in the future, but could not give an exact projection -- increases of 25% per year for the next few years have been mooted by Eskom.

¶10. (SBU) The electricity tariff increase will assist Eskom to cover its operating costs and has been positively received by the government. The government agreed that Eskom tariff revenues should reflect the full costs of supplying electricity, including a reasonable risk-adjusted margin or return to ensure the industry
Qreasonable risk-adjusted margin or return to ensure the industry
remains economically viable, stable, and fundable in the short, medium and long term. Labor, consumers, and business, on the other hand, are not as happy and say that, while the increase was in line with what had been expected, it would have negative effects in the medium term. They believe that the increase will affect input costs for business and generate a 'ripple' effect that will increase the price of most goods and services to consumers. This, in turn, would have a negatively impact on inflation, and cause a further slowdown in economic activity. Some accuse Eskom and government of poor management, poor planning, and underinvestment, which caused the energy crisis in the first place. Some trade unions opine that the increase is merely an attempt by government to shift the burden of Eskom's capital costs to consumers.

Eskom Coal Gasification Plant

¶11. (SBU) State-owned power utility Eskom's Majuba thermal power

station in Mpumalanga Province has been plagued by an inadequate supply of coal from its feeder mine. Coal has had to be transported by road from distant mines, and plans are to build an 80-kilometer rail link from the mines to the power plant for this purpose. The coal mine at Majuba hosts a 3.5 meter thick coal seam, 300 meters below ground. However, the nature of the geology prevents efficient bulk mining. Eskom embarked on a project to test the viability of utilizing the energy contained in the coal some three years ago. They employed a technique known as in-situ underground coal gasification (UCG), which has been successfully demonstrated in the U.S., Russia, and Australia.

¶12. (SBU) Under the UCG technique, boreholes are drilled into the coal seam, which is then ignited using oxygen injection to control the heat and the expansion of the "fire". The heat drives off the coalbed methane and gases generated by the partial combustion of coal, which are then run through gas turbines to generate electricity. Eskom's corporate consultant, Dr. Mark van der Riet, says that an efficient and cost-effective way to generate electricity using UCG is through integrated gasification combined cycle (IGCC) technology. The Council for Scientific and Industrial Research (CSIR) is currently developing a 6-megawatt demonstration plant and computer model to generate data for use in a feasibility study for the commercialization of a 2,100 megawatt plant.

Eskom Build Plan

¶13. (SBU) South Africa's overall electricity demand is running at an annualized 2.7% lower than the same time in 2008 due to the global economic crisis, according to Eskom Enterprises division MD Braam Conradie. This presented opportunities to significantly reduce the capital costs of projects underway he said. To date, 13 gigawatts of power are under construction, some 4,440 megawatts of capacity have been installed, 2,062 kilometers of transmission lines laid, and 10 by 100 megavolt-amp transformers completed. Eskom has put some projects on hold, namely the Tubatse pump-storage scheme and the Majuba rail line, but other projects will go ahead in preparation for the economic upturn. The "big two" thermal stations, Medupi and Kusile, and the pump-storage station Ingula, have a combined capacity of about 12 gigawatts (see above). Reports indicate the plants should be commercially ready between 2012 and 2017, will have greater input from the government, and are progressing on schedule. Although Eskom has decided not to proceed

with the Nuclear-1 investment for the time being, it claims to support nuclear power as the way forward and would continue developing its nuclear program, but with a partner and with greater involvement from the government.

MINING

Tata Eyes Coal Production in Mozambique

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¶14. (SBU) Tata Steel, the sixth biggest steel producer in the world, and its joint venture partner, Australia-based Riversdale, plan to start full production at the Benga coking coal project in Mozambique by 2014. Production should begin in 2011 and Benga is likely to yield over 20 million tons of coal per year. Tata Steel has a 35% stake in the JV and a secured right for 40% of the coal to feed its Corus facilities in the UK and Europe. Riversdale said it has completed the feasibility study, which envisages three stages of development of which it has obtained 65% ($169 million) of the funding for stage 1. The Mozambique government awarded a mining contract for Benga to the Tata Steel JV in May 2009.

Mine Hostages Freed

¶15. (SBU) Eastern Platinum's Crocodile River Mine (CRM) in South Africa has terminated the mining services contract for companies whose employees participated in an illegal industrial action of hostage taking. The mine spokesman said they would in the future use only permanent company employees to carry out core mining activities. Further, he said that charges had been brought against those who were engaged in the illegal actions.

¶16. (SBU) About 500 contract workers staged a sit-in on July 9, holding some nine supervisors underground to back their demands for permanent employment by the mine instead of by their respective contractors. The workers voluntarily returned to the surface on the morning of Saturday July 11, following successful mediation between the parties, and were repatriated home. Eastern Platinum CEO Ian Rozier said the sit-in had ended and the supervisors released unharmed. CRM management has indicated that it remains committed to ongoing discussion on this issue, but only through the appropriate channels provided under the terms of South Africa's labor relations legislation.

Mine Labor Negotiations and Wage Gaps

¶17. (SBU) Winter is generally the time of discontent in the South African mining industry. It is the time when annual wage negotiations get underway and everyone in the industry enters a stressful period until negotiations are concluded, generally by the end of July, if no strike action is taken. The South African industry and unions have generally resisted multi-year contracts for various reasons and this ensures industry disruptions on an annual basis. Wage negotiations for 2009 have been clouded by a year of high inflation and interest rates, a volatile currency, record high commodity prices followed by the financial crisis and record falls in commodity prices. Many commodity prices declined by more than 50%. Gold has been the one exception and it has generally retained its value. This situation has made it difficult for both labor and industry to put forward or respond to realistic wage demands, with labor generally looking backwards to the helicon days of 2007-2008 and industry looking forward to a possible bleak future for direction. Labor has demanded a 15% across-the-board increase in basic wages, a 21% increase of the entry level wage, and a number of other benefits, which the Chamber of Mines (COM) negotiator estimates would increase mine labor costs by 30% to 42%. The COM

has offered a 9.5% inclusive package increase and believes that the two sides are close to an agreement. This package has, with a higher rate for lower-paid workers, has been accepted.

¶18. (SBU) The wage gap between workers and top executives in the mining industry has increased during the past three years, despite the above-inflation wage increase awarded in 2008. According to a
Qthe above-inflation wage increase awarded in 2008. According to a
report by union-backed think-tank Labor Research Services (LRS), the ratio between workers' wages and chief executives' salaries increased from 401 in 2005 to 453 in 2008. LRS Director Saliem Patel acknowledged that these estimates did not include executive remuneration in the form of share options and the actual gap was likely to be wider. Research has shown that the wage of a general worker in July 2004 was R547 a week and R768 a week in 2009 ($89 and $90 at the respective dollar/rand exchange rates), an increase of 40% in rand terms, but zero in dollar terms. However, over the same period inflation was 29%, thus the real increase in wages was considerably less. The report indicates that industry profits have increased on average by 71% in 2005, 114% in 2006, and 19% in 2007 and 2008.

Free Market or Nationalized Mining

¶19. (SBU) The move in most African mining jurisdictions is towards a market economy and away from nationalization, according to the

International Bar Association mining law chairperson Peter Leon. He said countries such as Ghana, Tanzania, Namibia, and Botswana had introduced reforms to the mineral laws to encourage foreign investment. This contrasts with calls for the nationalization of South Africa's mining industry by the African National Congress and the South African Communist youth leagues and the Congress of South African Trade Unions. Leon welcomed statements by President Zuma and Mineral Resources Minister Susan Shabangu that nationalization of the mining industry was not on the government's agenda, but that a debate on the issue is needed. Leon said his concerns are that:
-- the call was in the midst of a global financial crisis and was probably aimed at testing stakeholder reaction;
-- the call coincided with the government's decision to revive the State-owned mining company; and
-- the debate could have negative implications for mining investment.
African Exploration Mining & Finance Corporation, the name of the proposed government mining company, was originally established in 1944 by the then South African government to support the war effort, but was never operational.

¶20. (SBU) Chamber of Mines Chief Executive Mzolisi Diliza said the South African government did not have the funds to nationalize the mining industry and pay market-related compensation. He said the industry was worth almost $250 billion on the Johannesburg Stock Exchange (JSE) and had an income of $51 billion in 2008. At the same time, expenditure was $51 billion and dividends paid amounted to only $3 billion. The Department of Mines Director-General Sandile Nogxina warned the industry that transformation should be accelerated and he saw no problem with a policy debate on nationalization. The mooted debate received a warmer reception from black investors, who expressed the belief that blanket nationalization will not work, but greater state involvement is required to achieve meaningful black economic transformation and the government's developmental goals. An economist who runs a small mining firm said the mineral rights already belonged to the state and there was a case to be made for government becoming a major shareholder in all of the mining operations in the country. He cited the success of joint ventures between diamond producer De Beers and the governments in Botswana (Debswana) and Namibia (Namdeb). Black investors all expressed concerns about government's ability to actually run mines should the assets be nationalized.

Travails of Anglo American

¶21. (SBU) Anglo American, the world's fifth biggest multinational mining company by value (including Chinese companies), is under siege. While it owns some of the best mineral and platinum assets in the world, Anglo has consistently underperformed its peers such as Australian-based BHP-Billiton, London-based Rio Tinto, and Qas Australian-based BHP-Billiton, London-based Rio Tinto, and Brazil-based Vale in acquiring quality assets, expanding production, and maintaining share price. Analysts point to poor management, where the company has consistently missed production, financial, and budget targets, particularly with regard to platinum. They also point to poor executive decision-making where peers have out-bid them for new assets, and iron ore assets and share buy-backs were bought at the height of the commodity boom. This, together with the slump in commodity prices, the cutting of thousands of jobs, and the group's missed profit forecasts, has cost shareholders their final 2008 dividend. As a consequence, questions are being raised about the leadership abilities of a number of Anglo's top management, in particular the relatively new CEO Cynthia Carroll.

¶22. (SBU) Anglo has been under pressure on a number of fronts. The Department of Minerals wanted Anglo to appoint a black South African to replace their retiring Chairman Mark Moody-Stuart "in the interests of black economic empowerment and transformation". Anglo resisted the pressure and appointed Englishman John Parker as chairman, but is still under pressure to appoint a black South African as Deputy Chairman. Anglo has also become a takeover target

for its peers. Xstrata, 35% owned by the world's biggest minerals and metals trading company Glencore, has made a bid for Anglo in "a merger of equals", which Anglo management rejected. Xstrata was created from Glencore coal assets. Its CEO, South African Mick Davis, has led Xstrata's growth by acquisition into the world's seventh biggest diversified metals and mining company by value. The rationale for the merger with Anglo, according to Xstrata, is that the combined company would bring about operating synergies (valued at about $1 billion), an enhanced scale of operations, and provide financial flexibility to fund future growth. A combined Xstrata-Anglo would be the world's biggest producer of thermal coal, platinum, zinc, and ferro-chrome; second largest copper producer; fourth in nickel; and among the top five in coking coal and iron ore. Opposition to the merger may come from competition authorities in a number of countries and from the SAG, which fears the loss of jobs and its influence over Anglo American. The battle continues.

La Lime